Today's internet bears little resemblance to its infancy. The government held the incumbents at bay long enough for the startups to grow and then watched as both old and new giants entrenched and consolidated control. Now startups launch with the express goal of being bought and subsumed by one of the Big Tech incumbents. Killer apps quickly become killer acquisitions.[4] Immeasurable innovation has been lost because the government stopped preventing dominance from blocking disruption.

The same economic calcification has happened in virtually every sector.[5] It is hard to quantify the benefits our society has lost from the discoveries and breakthroughs that never saw the light of day. Public policy choices, like narrowing the scrutiny of vertical mergers to allow mass consolidation, likely contributed to the startup slump. One of the many side effects of this decline has been the deterioration of supply-chain resilience and the reduction in productive capacity – both of which have become increasingly evident as the COVID-19 pandemic has unfolded.[6] If we don't change course on concentration, these economic failings are likely to further hamper our pandemic response and our economy recovery.

Unfortunately, the newly released Vertical Merger Guidelines support the status-quo ideological belief that vertical mergers are presumptively benign, and even beneficial. These benefits often accrue to incumbents at the expense of the competitive market,[7] a fact frequently overlooked by the theories underpinning this economic worldview. While the Guidelines state that the "Agencies are concerned with harm to competition, not to competitors,"[8] they rely on economic models that focus on changes to competitors' behavior instead of changes to the market or market structure. These speculative models are based on the often-inaccurate theoretical presumption that vertical mergers only change the relationships among market participants, not the number of market participants. Therefore, they assume that a merger's impact on competition can be measured by weighing the likely occurrence of certain abusive conduct against the potential for efficiencies that lower consumer prices.

But this balancing theory doesn't capture the ways that vertical mergers can restructure the market to make it difficult or impossible for other companies to compete with a merged firm. Indeed, mergers that reduce the actual or potential number of competitors are likely to create serious competitive concerns.[9] This should have been a central theme of the new Guidelines; but instead, they largely ignore the harms that result from merger-induced changes to market

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large or dominant firm enters a new market, as investors take stock of the overwhelming advantage afforded by its size and resources.

Conflicted gatekeepers

A vertical merger may allow a company to seize gatekeeper control of the market in which it participates. This creates a conflict of interest that gives the merged firm both the motive and the means to deter new entry. Investors gravitate toward companies that can extract rents from participants across a sector, so when a market participant vertically merges with a firm that controls a bottleneck, new entrants face dim prospects. There are myriad avenues through which such gatekeeper control can suppress entry and blunt competitive intensity. In digital markets, a platform company can impose arbitrary technical specifications that stifle disruptive innovation, require market participants to use the platform’s proprietary systems and pay for the privilege, levy taxes on disruptors that the platform’s own e market in5I dis173n(aw) l af2 (m)0.6 (u5ntrants f)8.6 dimr

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Increased customer-acquisition costs
Vertical mergers can significantly increase the cost of acquiring new customers. High customer-acquisition costs are a key metric that can deter investment in new businesses. The Vertical Merger Guidelines do not adequately address the ways that a vertical transaction, particularly those involving dominant platforms, may make it difficult, expensive, or otherwise unappealing to switch to a new entrant. The switching costs created by referrals, bundling, cross-product subsidization, below-market or zero-cost pricing, early termination charges, exclusive add-on deals, and other unfair advantages of vertical integration can obstruct new entry and should have received due consideration in the Guidelines.

Market Realities

Beyond the failure to capture the wide range of structural market changes that can harm competition, the theoretical models in the Vertical Merger Guidelines are based on an antiquated view of the economy that has little basis in modern market realities.[24] The Guidelines' continued reliance on these unproven theories reflects a lack of humility as to their efficacy.[25] And it comes despite numerous public comments that cast serious doubts about the accuracy of the theoretical predictions and expressed concerns about the significant weight that they are afforded.[26] In addition to their general inability to predict changes in merger-induced entry and exit, existing

vertical mergers facilitate. After all, it is difficult to stop abusive behavior when the market is structured to produce it. We need to start recognizing the inherent inability to resolve the harms to competition that some vertical mergers impose. I believe rigorous, empirical, structural analysis would lead the agencies to challenge significantly more vertical transactions instead of attempting to remedy them.

Conclusion

Since the publication of the last iteration of the Vertical Merger Guidelines a generation ago, we have learned a great deal about the incentives of firms and the individuals operating them, as well as how our global capital markets shape those incentives. We have also experienced – and are currently witnessing – how diminished firm entry can reduce dynamism, innovation, and resilience.

I appreciate that the Federal Trade Commission and the U.S. Department of Justice rescinded the old, outdated 1984 Guidelines. I welcome the sentiment from my colleagues that they are likely to challenge more vertical mergers that might have otherwise not drawn scrutiny. However, for new Guidelines to gain acceptance by courts and the public, they must reflect the limitations of old approaches and economic learning of the last generation. If not, they will not stand the test of time.